

# May 97 Access Ruling Yielded a Modest Decline in Costs to IXC's

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	Industry Impact (M)*			MCI Impact (M)		
	2H 97	1H 98	Total	2H 97	1H 98	Total
Reduced Access Charges	(\$800)	(\$2,859)	(\$3,659)	(\$165)	(\$591)	(\$756)
Implemented New Changes	0	2,515	2,515	0	480	480
Net Impact to IXCs	<u>(\$800)</u>	<u>(\$344)</u>	<u>(\$1,144)</u>	<u>(\$165)</u>	<u>(\$111)</u>	<u>(\$275)</u>

\* Estimates Based on:

LEC Tariff Review Plan, FCC Investigation Orders, FCC Estimates

# MCI Costs Decreased \$275M

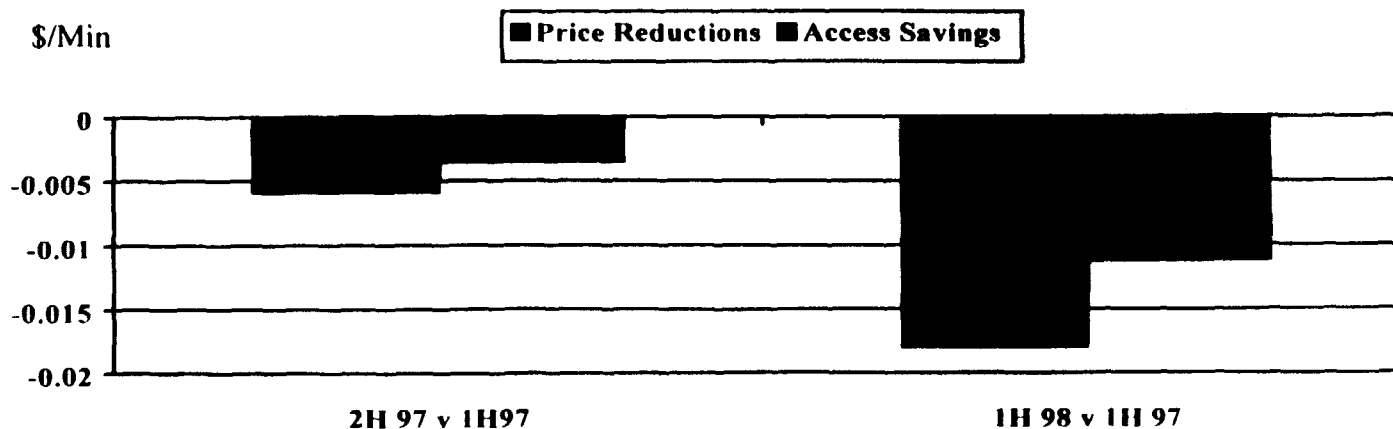
	2H 97 vs 1H 97		1H 98 vs 1H 97		Total		Total
	<u>Consumer</u>	<u>Business</u>	<u>Consumer</u>	<u>Business</u>	<u>Consumer</u>	<u>Business</u>	
Access Reduction	(\$56)	(\$109)	(\$207)	(\$385)	(\$263)	(\$493)	(\$756)
PICC Fees	0	0	69	112	69	112	180
USF Fees	0	0	107	193	107	193	300
Total	<u>(\$56)</u>	<u>(\$109)</u>	<u>(\$31)</u>	<u>(\$80)</u>	<u>(\$87)</u>	<u>(\$188)</u>	<u>(\$275)</u>

# MCI Passed Through Access Charge Reductions to End Users

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## Actions:

- \$.05 on Sunday
  - New Product
  - 20% Cash Back for SB
  - Customer Migration to Lower Rate Products
  - Contract renegotiations
- |                        |              |
|------------------------|--------------|
| Access Savings         | (\$756M)     |
| Total Price Reductions | <u>1,223</u> |
| Extra Customer Savings | \$467        |



# Two Line Family in Charleston

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- Young couple with two lines, college friends and relatives living throughout the South.
- Current long distance bill is \$60/month under a \$0.10/minute calling plan

## **FCC Prediction**

- Under FCC proposal, family's savings on total bill (local and long distance) is about 4% (\$2.50).

## **MCI Customer**

- Under MCI One, MCI's most popular plan, family's savings is about 11% (\$6.45).

# Funeral Parlor - Anywhere, USA

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- Funeral parlor has three lines, mainly for incoming calls. Owner makes 15 minutes of long distance calls/month.

## FCC Prediction

- Current LD bill is \$7
- Under FCC proposal, total bill increases by about \$13.00/month.

## MCI Customer

- Under MCI rates and Per Line PICC recovery of \$2.75 per line, bill increases by \$12.

# Travel Agency in Sioux Falls, SD

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- Three phone lines for two agents. Each agent makes about 2.5 hours of long distance calls per day.
- Total long distance bill (all lines) is about \$790 per month, about \$930 including local.

## **FCC Forecast**

- Total bill under FCC proposal declines by about \$52, or about 6%.

## **MCI Customer**

- Under MCI One with Per Line PICC recovery, bill increases by only \$11.25 (1.6%).
- With 20% MCI One rebate, bill declines by \$135 (18%).

# Senior Citizen in Miami

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- Calls grandchildren in California for 10 minutes every other week.
- No calling plan, long distance bill is about \$4.00 per month.

## **FCC Forecast**

- Under FCC proposal, local bill is unchanged, long distance bill falls by about 8%.

## **MCI Customer**

- With 5 Sundays and by timing her calls, long distance bill decreases by 17-48%.
- If 50% calling off peak and 50% on Sunday, bill declines by 17%.
- If all calling on Sunday, bill declines by 48%.

# Industry Rate Decline Trend Accelerates in 2H 1997

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2H 97 Industry Rate Decline	1,436
2H 97 Industry Access Savings	<u>(800)</u>
2H 97 Industry Extra Customer Savings	<u>\$636</u>

**\$1.80 Savings per \$1 of Access**

Source: Earnings Reports and Industry Analyst Report



# **This Reality was Recognized by the FCC**

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*“Long distance rates fell 5.3%  
between January 96 and November  
97. Long distance prices are now at  
the lowest they have ever been.”*

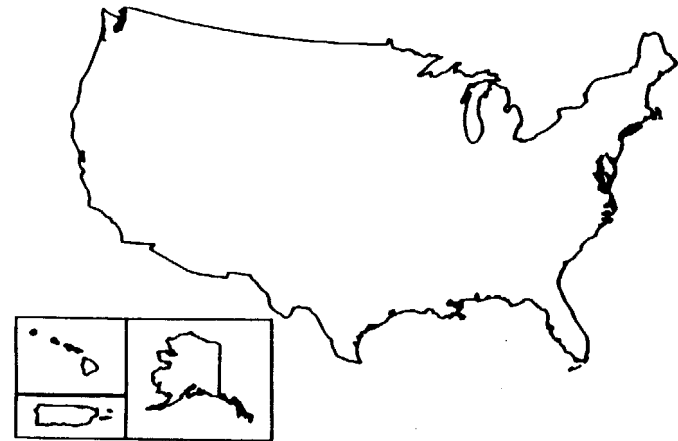
FCC Chairman William Kennard  
Speech to National Association of  
State Utility Consumer Advocates  
February 9, 1998

# Access Reductions have Resulted in Lower Prices

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Access Savings



So new charges must be recovered

# **MCI's Recovery Method for PICC and USF Charges Varied by Market Segment**

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	<u>Consumer</u>	<u>Small Business</u>	<u>Large Business</u>
PICC	\$1.07 Per Account	Tiered % of revenue structure moving to \$2.75 per line	\$2.75 Per Line
USF	Recovery to begin 7/1/98	5% of Revenue	4.4% of Revenue

# **MCI Expects to Under Recover New Charges by \$160M in 1H 1998**

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	<u>USF &amp; PICC Charges</u>	<u>USF &amp; PICC Recovery</u>	<u>Net</u>
Consumer	(\$176)	\$69	(\$107)
Business	<u>(305)</u>	<u>252</u>	<u>(53)</u>
Total	<u>(\$480)</u>	<u>\$321</u>	<u>(\$160)</u>

# Summary & Implications

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- 1) MCI savings passed to customers have exceeded access reductions by \$467M.
- 2) MCI will under recover PICC/USF by over \$200M in 1998.  
(\$160M in 1st half alone)
- 3) The real costs to MCI are going up and are scheduled to go up even more.
- 4) MCI rates should reflect both the nature (per line) and amount of its costs.
- 5) The problem remains with the \$30B in access charges.  
They are:
  - Illegal: Telecom Act bars implicit subsidies
  - Anti-competitive: They close the local market and distort the long distance market
  - Economically Irrational: A minute is a minute

# A Minute Is A Minute. However...

## Conversation Minutes

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### Local Interconnection\*

	<u>Cents</u>
• New York Telephone	2.87
• Michigan Bell	2.59

### Interstate Access

	<u>Cents</u>
• New York Telephone	5.1
• Michigan Bell	4.2

\*Local interconnection rates include a per-minute equivalent of the unbundled local loop rate

# **FCC Must Make Fundamental Changes to Access**

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- Prescribe access rates to forward-looking cost
  - CFA, NRF, ICA Petition
- Require ILECs to collect PICC directly from end users
- Eliminate distinction between primary and non-primary residential lines
- Require ILECs to make IXC federal universal service contributions explicit, including that portion billed to IXCs through interstate access charges

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Mark C. Rosenblum  
Vice President - Law & Federal  
Government Affairs

Suite 1000  
1120 20th St. NW  
Washington, DC 20036  
202 457-2120  
FAX 202 457-3205

March 5, 1998

The Honorable William E. Kennard, Chairman  
Federal Communications Commission  
1919 M Street, NW, Room 814  
Washington, DC 20554

Re: CCB/CPD 98-13

Dear Chairman Kennard:

AT&T's Chairman and CEO C. Michael Armstrong has asked that I respond to your February 26, 1998 letter, and to set the record straight on the allegations made by the United States Telephone Association ("USTA") about interexchange carrier ("IXC") pricing and access flowthrough. AT&T's response again confirms, as we have consistently stated, that AT&T customers are in fact paying lower actual prices for long distance service -- and that our long distance prices are dropping faster than the access charges that we must pay to local exchange carriers ("LECs").

The good news here is that long distance competition remains a singular success for the customer, in terms of choice, innovation and price. Even though access prices and the new universal service fund ("USF") charges are too high, AT&T's customers continue to pay lower prices that more than reflect the modest reductions in interstate access charges that have occurred. Indeed, for the period July 1, 1997 to June 30, 1998, AT&T's average revenue per minute ("ARPMin") for interstate services has dropped by almost \$2.5 billion, almost \$1 billion more than the \$1.5 billion in interstate access reductions received by AT&T. Moreover, these interstate reductions are dwarfed by the massive and unjustified profits monopoly LECs continue to earn from access rates inflated above true economic costs by almost \$10 billion.

In these circumstances, AT&T submits that the real challenge in the telecommunications industry today is genuine access reform and opening local telephone markets



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to meaningful competition. If the Commission would make cost-based access pricing a reality, and implement the new USF at more appropriate and competitively-neutral levels, the prospects for local competition would be brighter, and long distance prices could fall even faster.

First, it is clear that AT&T's customers are paying prices for long distance service, as measured by ARPMin, that are falling faster than the level of interstate access charges AT&T must pay. Unlike customers of monopoly LECs who have no choice of service and price plans, long distance customers enjoy a broad and expanding array of price and service offers, from hundreds of competing providers. As a result of this competition, customers can and do obtain lower and lower prices (that more than reflect access reductions) through reduced rates in filed tariffs, promotional offers, custom contract offerings for business customers (or renegotiation of existing services provided under such contracts), and movement by customers to more attractively priced services (for example, optional calling plans like AT&T's One Rate plan). The best measure of price is the amount customers actually pay for long distance in a given period. The industry standard for measuring price is ARPMin: long distance revenues divided by long distance usage. When ARPMin is falling faster than per-minute access charges (as it is), then AT&T's customers are getting the full benefit of access cost reductions.

AT&T has estimated that, for the period July 1, 1997 to June 30, 1998, AT&T's ARPMin for interstate services has dropped by nearly \$2.5 billion. Customer savings in excess of access reductions realized by AT&T for that period are projected to be \$977 million. AT&T thus passes far more than 100% of its savings in access costs through to its subscribers in the form of lower prices paid by those subscribers for AT&T's services.

Against this massive decline in the amounts customers actually pay for AT&T service, the total access cost savings to AT&T attributable to reductions in interstate access charges pales by comparison. AT&T's total access savings are estimated to be \$1.4743 billion for the period July 1, 1997 to June 30, 1998. This total was computed by subtracting the per minute access charges AT&T expects to pay for that period from what it would have paid for the prior twelve-month period under the LEC access charge tariffs in effect during that period. Specifically, AT&T multiplied its demand by representative access charges in effect from July 1, 1996 to June 30, 1997, multiplied its demand by access charges revised to reflect revisions to access charges effective July 1, 1997 and January 1, 1998, and subtracted the products of those two

calculations, which equals \$1.7028 billion. From this, AT&T subtracted the new costs it has incurred for the payment of PICCs to local exchange carriers. For the period July 1, 1997 to June 30, 1998, AT&T will pay \$543.0 million more than it would have under the access charges in effect on June 30, 1997, which included no PICCs. Finally, AT&T added back in, for the period July 1, 1997 to June 30, 1998, the \$314.5 million amount reflecting reductions in access charges due to the elimination of the old high cost fund.<sup>1</sup> These calculations result in a total reduction in AT&T's interstate access costs for this period of \$1.4743 billion.

As the table below illustrates, the "net" of AT&T's total ARPMin reductions and its total access savings amounts to \$977 million.

**Customer Savings in Excess of Access Reductions**  
 July 1, 1997 to June 30, 1998  
 (\$ in millions)

	TOTAL
Access Cost Reductions	(1,474)
ARPMin Decline	(2,451)
Customer Savings in Excess of Access Reductions	977

Although, as the above table shows, AT&T customers, in fact, are enjoying lower long distance prices that more than reflect access savings AT&T has realized, the data are conservative because these figures do not include the additional cost burden imposed on AT&T by the Commission's new USF rules. AT&T's contributions to support universal service programs for the period from January 1, 1998 to June 30, 1998 were calculated using USAC 1998 first quarter contribution factors, AT&T's estimate of the second quarter 1998 factors, and AT&T's revenues from its filed Form 457 USF Worksheet. The second quarter contribution factors were developed based on funding caps established by the Commission in CC Docket No. 96-45 and the revenue bases reported in FCC Public Notice DA 97-2623.

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<sup>1</sup> Although AT&T's analysis reflects a reduction in its access costs due to the elimination of the old High Cost Fund ("HCF"), AT&T has not included in the above table the new separate costs it bears as a result of its required contributions to the new USF.

**Universal Service Contributions**  
 January 1, 1998 to June 30, 1998  
 (\$ in millions)

High Cost Support	395
Low-Income Support	114
 Schools, Libraries and Rural Health Care	 155
 Total AT&T Universal Service Contributions	 664

Limited recent actions by AT&T to recover some of the new costs (namely, USF assessments and PICCs) added to the system do not change this. They include mechanisms that seek to recover no more than AT&T's actual cost of contributing to the new programs in respect of the customer; in fact, AT&T underrecovers by a wide margin. AT&T is not generating profits on USF recovery because it is already flowing through more in price reductions than it has received in access reductions. Moreover, because of systems and implementation requirements, as well as price-guaranteed contracts, AT&T currently is only recovering a portion of the new USF assessment associated with business services, and it is not recovering as a line-item on the consumer bill any of the assessment associated with residential services. For example, although for business services AT&T's USF payments are \$302 million, it is recovering only two-thirds or \$198 million through a line-item on the bill. Similarly, while AT&T's liability for PICCs for business customers is approximately \$245.5 million, it is only recovering approximately \$49 million through line-item charges on the bill. As you also know, AT&T is considering actions to begin recovering some additional portions of the USF and PICC costs.<sup>2</sup>

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<sup>2</sup> Even if any such actions are taken (for example, a PICC recovery mechanism for non-basic schedule residential customers of no more than \$0.95 per month), residential and business customers will each still enjoy a significant net decrease in actual price paid.

Indeed, because the additional expenses associated with USF payments, commencing January 1, 1998, more than offset USF recovery and PICC recovery (including planned PICC recovery for residential customers), the figures show an even greater consumer saving as compared to AT&T's costs. Because of competition, this proves that AT&T customers are able to take advantage of better and better price plans, in larger and larger numbers, thus reducing their overall long distance bill.

**Net Customer Savings in Excess of Access Reductions  
and PICC/USF Recovery**

July 1, 1997 to June 30, 1998  
(\$ in millions)

	TOTAL
Customer Savings in Excess of Access Reductions	977
PICC Recovery	(83)
Planned Blended PICC Recovery (4/1/98-6/30/98)	(91)
USF Payments (1/1/98-6/30/98)	664
USF Recovery	(198)
 Net Customer Savings in Excess of Access Reductions and PICC/USF Recovery <sup>3</sup>	 1,269

Finally, AT&T is especially surprised at questions raised in your letter with respect to how we label PICC and USF charges on the customer bill. AT&T has been particularly active and forthcoming with you and your staff, and with others in Washington, about its plans. AT&T decided in December, 1997 not to put a separate USF charge on residential bills until at least July 1, 1998. Where AT&T has separately charged such items (to business and wireless customers), we have been scrupulous to observe the Commission's request that such descriptions be accurate: we always make clear that AT&T must pay these charges and AT&T has chosen to recover them through a separate assessment on the bill. Moreover, we have worked hard with the Commission and others to share our descriptive language and meet any concerns.

<sup>3</sup> The net customer savings in excess of access reductions and PICC/USF recovery is computed by subtracting from Customer Savings in Excess of Access Reductions the additional revenues AT&T expects to recover through P ICCs, Blended P ICCs, USF Recovery, and adding back USF Payments.

I trust this fully addresses the issues raised in your letter and that the Commission will continue its focus on local markets, so that the promise of the 1996 Telecommunications Act can become a reality. In short, AT&T has already flowed through to customers more than the access cost reductions it has received, and strikingly more than that when the new USF program costs are taken into account. Far more impressive long distance price cuts are possible, but the Commission holds the key. Interstate access reductions in July 1997 and January 1998, welcome as they were, amount to a small fraction of the total access revenue stream enjoyed by the LECs. AT&T estimates that these revenues exceed by a massive \$8-\$9 billion the LECs' true cost of providing access. If the FCC were to act to ensure that access prices reflect these costs, far larger reductions in long distance pricing would be assured.

Respectfully yours,

A handwritten signature in dark ink, appearing to read "M. K. Powell", written in a cursive style.

cc: Commissioner Susan Ness  
Commissioner Michael K. Powell  
Commissioner Harold W. Furchtgott-Roth  
Commissioner Gloria Tristani



J. Richard Devlin  
Executive Vice President  
General Counsel and External Affairs

P.O. Box 11315  
Kansas City, MO 64112  
Telephone (913) 624-8440  
Fax (913) 624-8426

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March 4, 1998

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

The Honorable William E. Kennard  
Chairman  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

Dear Chairman Kennard:

Thank you for your letter of February 26, 1998. Sprint appreciates the opportunity to correct the record concerning access and universal service costs and Sprint's long distance pricing.

First, the premise of cost reductions is wrong. There were no access and universal services cost reductions on January 1, 1998. On the contrary, Sprint estimates that its interstate access costs and USF costs, taken together, rose by some \$28 million on January 1, 1998, as compared with July 1, 1997 levels. Estimates are being used because Sprint has not received detailed, auditable Primary Interexchange Carrier Charges (PICC) bills from the LECs.

We believe that the long distance industry faced overall increases in access charges and universal service of some \$316 million on January 1, 1998. This estimate is based on corrections to data supplied by USTA in letters dated February 11, 1998 (from Mr. Neel), and February 20, 1998 (from Ms. McDermott). See Attachment 1.

Second, when viewed in context, long distance prices continue to drop significantly. As the Common Carrier Bureau's Industry Analysis Division recently reported, between 1992 and 1996, long distance billed revenue per minute dropped by 2.9 cents per minute, while access costs during this same period fell by only 1.2 cents.

Attachment 2 shows Sprint's experience between 1995 and 1997. Sprint's revenues per minute fell more than twice the drop in access

March 4, 1998

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costs. In 1997, Sprint customers got some \$500 million in price reductions over and above access reductions.

In anticipation of access reform, Sprint bombarded the marketplace with promotions and new product offerings throughout 1997 and has continued to do so into 1998.<sup>1</sup> A list of these promotions and products can be found in Attachment 3. As a result of these new offerings, Sprint revenues per minute continue to fall. This decline has far outstripped the changes in access costs that Sprint has incurred to date, even when expected revenues from Sprint's Presubscribed Line Charge ("PLC") - the charge that it uses to recover PICC costs - and its Carrier Universal Service Charge ("CUSC") - its charge designed to recover Universal Service Fund costs - are taken into account. Specifically, while Sprint's combined access and USF costs are expected to decline by approximately a quarter of a cent between the first quarter of 1997 and the first quarter of 1998, average revenue per minute for those same periods (including the effect of Sprint's new PLC and CUSC) will fall by as much as twice that amount. Thus, the short answer as to why Sprint did not "simultaneously" reduce usage rates when it instituted its PLC and CUSC is that, in reality, it had already done so.

Sprint's new PLC and CUSC charges were not designed as rate increases, but as necessary structural changes to reflect a change in the way costs are imposed on Sprint. The new fixed monthly PICC charges will change fundamentally the way Sprint incurs access charges. For example, a significant number of Sprint's presubscribed customers in any month make few if any calls or use dial-around carriers. Sprint's PLC charge is the only way to recover this new access cost relating to such customers.

Similarly, the significant expansion of universal service funding, with the promise of even greater expansion in the future, makes it important for Sprint to differentiate this item of expense. In addition to direct contributions to USF, the long distance industry bears an additional \$830.2 million, or 96.4 percent, of the USF contributions made by the LECs, which the Commission permitted the LECs to pass onto long distance carriers through access charge increases. Directly or indirectly, the long distance industry is being forced to absorb 90 percent of total USF costs. Whether this outcome can be reconciled with the statutory requirement for a nondiscriminatory and competitively neutral USF is the subject of pending appeals. Nevertheless, if the Commission wishes to use long distance carriers to fund programs that are deemed to be in the

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<sup>1</sup> Forward pricing, i.e., reducing prices now based on anticipated cost reductions, is customary in a competitive market.

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public interest, we need to be able to pass those charges directly to customers in an open and fair manner.<sup>2</sup>

Finally, your letter references and relies on information provided by USTA. USTA is funded principally by the RBOCs and, as such, promotes the RBOC agenda for long distance authority. That agenda is the two big lies -- that local telephone service is competitive and long distance is not. Well, if local telephone service is competitive (i.e., conditions are such that entrants have a reasonable prospect of making a return on their investments), why aren't RBOCs entering each others' markets on a large scale? Why aren't local rates going down? Why don't the RBOCs have seven pages of rate reductions, retention programs and promotions similar to Sprint's Attachment 3? And if long distance is not competitive, why, as shown herein, are per minute yields plummeting?

Sincerely,

A handwritten signature in cursive script, reading "J. Richard Devlin".

J. Richard Devlin

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<sup>2</sup> Sprint's notifications to customers concerning PICC and Universal Service charges were not misleading. See Attachments 4 and 5.





# Attachment 1

## Reconciliation of Jan. 1, 1998 Access Reductions

### Sprint and USTA

USTA Total Reported IXC Increased Costs	\$ 70,000,000
Sprint Estimated IXC Increased Costs	\$ 316,157,513
Difference	\$ (246,157,513)
USF Differences *	\$ 189,814,240
GTE Direct Case Order **	\$ 56,220,684
Total	\$ 246,034,924
Variance	\$ (122,589)

\* The USF Difference:

FCC USF Revenue Category	Total Revenues (End Users)	Interstate & International (End Users)
IXC	\$ 35,697,962	\$ 26,654,989
Operator Services	\$ 226,778	\$ 129,416
Other Toll	\$ 94,372	\$ 58,267
Prepaid Calling Cards	\$ 54,617	\$ 41,366
Toll Resellers	\$ 3,165,522	\$ 1,948,541
Total IXC End User Revenue	\$ 39,239,251	\$ 28,832,579
Total FCC Reported End User Revenue	92,156,436	35,314,379
Sprint Calculated IXC % of Fund	42.58%	81.65%
USTA Calculated IXC % of Fund	38.74%	75.48%

In calculating USF costs for the IXCs, USTA used only facilities-based IXC revenue, excluding prepaid card providers, toll resellers, operator service providers and other toll. Including the USF obligations of all IXCs results in a direct burden of \$2401.8 Million rather than the \$2211.9 Million estimate provided by USTA, a difference of \$189.8 Million. The \$2401.8 Million is calculated by multiplying the corrected IXC percentages (shown above) by the USTA provided USF revenue requirement estimate of \$1350 for Schools and Libraries and \$2237.7 for High Cost and Lifeline.

\*\* GTE Direct Case Order was ordered as a restatement of GTE's July 1, 1997 filing.

We have included this as a part of the reduction the FCC gave before the Jan. 1, 1998 filings that lowered access an additional \$200 million to increase the July 1, 1997 filing to \$1.7 billion in total access reductions.